THE EFFECTS OF TARGETED IMPORT SURCHARGES

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A variety of proposals have recently been made to impose surcharges on imports from selected U.S. trading partners. This report concerns the economic effects of such targeted surcharges. It was requested by Senator John C. Danforth, Chairman of the Subcommittee on International Trade of the Senate Committee on Finance.

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INTRODUCTION AND SUMMARY

The Congress is currently considering a variety of proposals that would impose surcharges on the imports of selected U.S. trading partners. This study discusses the economic implications of such targeted surcharges.

Surcharges, in general, tend to redistribute economic activity and, by doing so, lead the U.S. economy to divert its resources away from the production of those goods that it produces most efficiently. They encourage the production of domestic substitutes for imports and, therefore, increase output and employment in those industries. But these benefits may be offset by losses elsewhere in the U.S. economy by:

- Raising the U.S. price level and, therefore, reducing the real purchasing power of U.S. consumers;
- Raising the prices of imported components or inputs that are used in the production of U.S. goods (such as integrated circuits used in computers or specialized metals used in aircraft engines), thus reducing their competitiveness in world trade;
- Reducing the incomes of those nations that export to the United States and, as a consequence, their ability to buy U.S. exports;
- Forcing a further appreciation of the dollar, thus handicapping U.S. exports; and
- Inviting retaliation by other nations.

Targeted surcharges, in contrast to general ones, raise a variety of other issues. First, what criteria should be used to determine which nations will be targeted? Virtually any criterion contains some element of arbitrariness or unintended effects. Criteria based on merchandise trade, for example, aimed at such nations as South Korea or Taiwan, could also target such nations as Italy or West Germany. A second issue concerns the poten-

tial for "origin swapping"; that is, substituting imports from untargeted nations for those from targeted ones--such as untargeted Mexican steel for targeted Japanese steel. This possibility makes the effects of targeted surcharges more difficult to predict than those of general ones, since a targeted surcharge could change the composition of U.S. imports without any real effect on their overall level. Such a circumstance would reduce both the negative effects of the surcharge and the benefits it creates for industries that compete with imports. 1/

The effects of surcharges on the targeted nations must also be considered, particularly in the cases of nations that need to run trade surpluses to finance large debt burdens. Brazil, for example, has a $6 billion merchandise trade surplus with the United States, but will need approximately $45 billion in 1985 to pay principal and interest on its outstanding debt to foreign lenders. Finally, the decision to target surcharges implicitly regards balanced bilateral trade as a policy goal. Bilateral trade imbalances, however, may be the norm in a world of nations with diverse resources, abilities, and economic situations. The United States itself, for example, exported 50 percent more than it imported from the European Community in 1980.

Targeted surcharges also raise the issue of the United States' commitment to the procedures set forth in the General Agreement on Tariffs and Trade (GATT), the international covenant that has promoted free trade throughout the post-war period. While the GATT sanctions a variety of protectionist practices for nations that are injured by imports of specific goods or by balance of payments difficulties, surcharges aimed at selected nations are not permissible under GATT rules. A unilateral abridgement of GATT procedures of the magnitude of a targeted surcharge may not only invite further action that weakens the GATT, but would call into question the U.S. credibility in other international economic agreements.

GENERAL EFFECTS OF IMPORT SURCHARGES

The economic losses associated with either general or targeted import surcharges can be understood best by comparing a world of free international trade with a world characterized by national economic self-sufficiency. By

1. In fact, considerable administrative effort would be needed to prevent fraudulent circumvention of a targeted surcharge, either by shipping finished goods to untargeted countries for reshipping to the United States, or by misrepresenting the origins of goods in shipping invoices.

producing and exporting goods that they can make cheaply, relative to other countries, and importing other goods from nations with different relative production costs, all nations can lower the cost of securing the goods they seek to consume. 2/ In contrast, any nation that attempts to be economically self-sufficient endures unnecessary costs, since there are always some goods that a nation wants that are relatively expensive for it to produce because of the specific physical, natural, or human resources required. Nations with limited agricultural capabilities, for example, could find the costs of feeding their populations staggering if left to rely on their own resources. Thus, international trade can facilitate the efficient use of resources by allowing a nation to specialize in forms of production that it does best because of the nature of its productive capabilities and resource endowments, while still securing all of the goods and services it seeks to consume. 3/

Import surcharges--either general or targeted--unravel this fabric of international exchange. To the extent that they are effective, by raising prices for imported goods, they encourage the production of domestic substitutes for those goods and thereby create new output and employment in those industries. But at the same time they lead the U.S. economy to divert resources from its most efficient forms of production toward production of those goods that could more efficiently be purchased from abroad. The redistributive effects of surcharges may favor some individual industries over others, but a loss of economic efficiency for the economy as a whole is almost inevitable. This loss, in turn, lowers long-term economic growth and standards of living.

The negative effects of an import surcharge are more widely dispersed than their positive effects, which are concentrated on import-competing industries. But these negative effects are nonetheless tangible, and materialize in a number of ways. First, by restricting foreign competition, surcharges lead to higher prices for domestic goods, thus lowering the purchas-

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2. In the language of economics, this capability is called "comparative advantage." A nation has comparative advantage in the production of a good when it can produce that good at the greatest cost advantage (or least cost disadvantage) relative to other goods, when compared with the parallel cost advantages of its trading partners. Even a nation without an *absolute* cost advantage in the production of any good can identify one good in which its costs, relative to its trading partners, are the least disadvantaged. It is this *comparative* advantage that brings about specialization in international trade.

3. For further detail, see Congressional Budget Office, *The Effects of an Import Surcharge on National Welfare: A Qualitative Analysis*," Staff Working Paper (March 1985).

ing power of U.S. consumers. Moreover, since surcharges lead to a higher price level, they make any given monetary policy appear more restrictive, and could, therefore, lead to higher interest rates and further reductions in output. In addition, many U.S. industries produce exportable finished goods using foreign components (for example, U.S. computers often include foreign semiconductors); the competitiveness of these exports would be hurt by the higher prices surcharges would create for their component parts. A surcharge that reduces imports also reduces the volume of U.S. dollars exchanged for foreign currencies with which to buy foreign goods, and is therefore likely to appreciate the dollar relative to other currencies, which would penalize U.S. exports. Internationally, restricting other nations' exports to the United States may lower their societal incomes and, therefore, reduce their ability to purchase U.S. exports. Finally, trade restraints such as import surcharges invite retaliation by nations that are injured by them--in fact, under the General Agreement of Tariffs and Trade (GATT), it is their right. This raises the prospect of a "trade war" that damages all those concerned. 4/

Beyond these effects, surcharges do not address the primary source of the U.S. trade deficit--the high value of the dollar in international exchange markets, which is caused, in large part, by large U.S. budget deficits. 5/ Budget deficits are linked to trade deficits through international capital flows. Federal deficit spending must be accommodated by private sector saving, but given competing private sector demands for funds (such as for investment or consumer credit), the existing level of private saving falls short of satisfying all of these demands. For the major trading partners of the United States (as a group), however, the opposite situation prevails: saving is a higher proportion of national income, and the demands for saving (both public sector deficits and private sector borrowing) are relatively low. Thus, the United States has been able to borrow extensively from abroad to finance its budget deficits.

But this extensive borrowing from abroad (as much as $100 billion in 1984) also increases the demand for dollars, since foreigners who seek to lend funds to the United States must buy dollars in order to do so. This demand bids up the price of dollars--the exchange rate--on international

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4. In fact, the trade wars precipitated by the Smoot-Hawley tariffs of the 1930s led to a collapse of the international trading system, contributing to the length and depth of the Depression.

5. For more on this relationship, see Statement of Dr. Rudolph G. Penner, Director, Congressional Budget Office, before the Subcommittee on Economic Stabilization, House Committee on Banking, Finance, and Urban Affairs (July 18, 1985).

markets. In fact, between January 1980 and March 1985, the dollar rose by 60 percent (corrected for inflation) against other major currencies. The dollar's high value makes U.S. exports more expensive abroad and makes foreign goods less expensive in the United States. In fact, one recent analysis estimated that dollar appreciation explained 87 percent of the total deterioration in the nominal trade deficit between the fourth quarter of 1980 and the fourth quarter of 1984. 6/ As a result, the United States incurred a current account deficit of $101.5 billion in 1984. 7/ As long as U.S. fiscal deficits necessitate extensive foreign borrowing, this pattern of a sharply appreciated dollar and significant trade deficits could persist.

Bilateral trade deficits also reflect the economic policy considerations just discussed. The United States' largest bilateral merchandise trade deficit--$37.2 billion in 1984--was with Japan. Trade restraints exist, both in the United States and Japan, and those in the latter have contributed to the large Japanese merchandise trade surplus with the United States, while, on balance, our trade restraints may have curbed it somewhat. The Japanese trade surplus, however, has grown dramatically in the recent past, while no evidence suggests that the level of protection in either market has grown at a comparable rate. The growing Japanese trade surplus may be more readily explained by a U.S. budget deficit and a U.S. saving rate that are, respectively, far greater and smaller than their counterparts for our trading partners, including Japan. As a result, Japan has become a substantial net contributor to the global capital pool, while the United States has been a substantial net consumer of global saving. These capital flows have helped bid up the price of dollars relative to the yen, leading to a dramatic deterioration in the U.S. trade balance with Japan. 8/

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6. See Congressional Budget Office, *The Economic Budget Outlook: An Update* (August 1985), p. 50.

7. The current account deficit is the sum of the merchandise and services trade deficits, including financial transfers. In 1984, the U.S. merchandise trade deficit of $123.3 billion was offset by a $21.8 billion surplus of services trade and other earnings. The terms "trade deficit" and "trade balance" used in this report refer to the merchandise balance, unless otherwise stated.

8. This process has been augmented by the recent deregulation of Japanese capital markets, allowing larger capital outflows from Japan. Thus, to some extent, capital outflows from Japan and their effect on the dollar-yen relationship could represent a correction of the currency pattern that existed when Japanese capital markets were regulated. That is, the yen may have been relatively overvalued in the past as a result of restrictions on capital outflows from Japan.

SPECIFIC EFFECTS OF A BILATERAL SURCHARGE

Beyond the general effects of import surcharges, surcharges targeted at individual nations or groups of nations have other implications. These issues include how nations targeted for surcharges would be chosen, the prospects for widespread "origin swapping" (in which imports from untargeted nations are substituted for imports from targeted ones), the effects of a surcharge on the targeted nations, and the desirability of balanced bilateral trade as a policy goal.

Criteria for Targeting

Implementing unilateral restrictions on the exports of specific countries presents several problems. First and foremost is the choice of criteria for choosing targeted nations.

Market Access. One frequently cited criterion is market access, often termed "fair trade" or "reciprocal trade," in which markets abroad are sought to be as open to imports as are corresponding markets in the United States. While it may be that U.S. markets are generally more open than their foreign counterparts, it is extremely difficult to measure "openness." Studies of Japan, for instance, find that its trade surplus with the United States is not primarily the result of trade barriers but rather of basic economic factors, such as the dollar's value and Japan's relative cost advantages in many manufactured products.[9] Average tariff levels in both nations are at approximately the same low levels; in fact, average Japanese tariffs are somewhat lower than those of the United States. Non-tariff barriers (NTBs)--that is, actions or policies that keep out foreign goods--are often more difficult to measure. Every country maintains some NTBs (for example, the United States restricts imports of textiles and steel, just as France impedes imports of some electronic equipment). In other cases, NTBs are difficult to identify. For example, are domestic health and safety standards or specifications for product reliability a barrier to imports specifically, or are they an exercise of national sovereignty designed to promote social welfare? Most analysts believe that NTBs probably account for a small percentage of the overall U.S. trade imbalance with Japan and other countries, even though they may be extremely important in the trade of specific goods.

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9. See, for example, Gary Saxonhouse, "The Micro-and Macroeconomics of Foreign Sales to Japan," in *Trade Policy in the 1980s*, William R. Cline, ed. (1983) Institute for International Economics, Washington, D.C.

Trade restrictions are usually applied to individual commodities. A criterion of "fair" or "reciprocal" trade in all markets is somewhat arbitrary. On average, current international trade practice aims at a broader standard of equivalence of protection--that is, it allows a nation to balance its trading partners' restrictive practices with comparable protection in different markets. Thus, surcharges targeted at individual nations will penalize imports of all goods from those nations, whether they are fairly or unfairly traded. The effect of such action is unclear: would it encourage greater openness in markets that are now closed, or hinder the application of current trade rules and encourage further market restrictions?

Bilateral Trade Deficits. The bilateral merchandise balance has also been suggested as a basis for targeting. One proposed criterion is the ratio of exports to imports, with surcharges aimed at nations with ratios above some trigger level. 10/ It should be noted, however, that such a criterion might have condemned large U.S. trade surpluses in the past. In 1980, for example, the U.S. exported nearly 50 percent more merchandise than it imported from the European Community. Table 1 shows 1984 bilateral and multilateral trade data for the countries with which the United States had the greatest bilateral trade imbalances. Included on the list are Japan, Taiwan, West Germany, Hong Kong, Brazil, Italy, and South Korea, in descending order of their merchandise trade balances with the United States. 11/ Combined, these countries accounted for over 60 percent of the total U.S. trade deficit in 1984.

The merchandise trade deficit, however, is only one component of a nation's trade with the rest of the world. An alternative measure of trade might be current account surpluses (the current account includes services and financial transfers, making it a better indicator of a country's total external balance) or current account surplus as a percentage of GNP. On a current account basis, U.S. performance does not appear to be as bad as it does when one views merchandise trade alone. On a worldwide basis, the United States imported nearly 60 percent more merchandise than it exported in 1984, but this figure drops to 28 percent on a current account

10. H.R. 3035, for example, would impose surcharges on all nations with nonoil merchandise export to import ratios above 1.65 in their bilateral trade with the United States, or 1.50 on a global basis.

11. Bilateral balances are those reported by the United States. In some cases, multilateral trade data are either unavailable or available only for early years, raising questions about the appropriate data base for calculating trade deficits.

TABLE 1. TRADE DATA FOR SELECTED COUNTRIES, BASED ON U.S. BILATERAL TRADE DEFICITS, 1984

Country	Bilateral With United States				Multilateral			
	Merchandise Exports to U.S. (In billions of dollars)	Merchandise Imports From U.S. (In billions of dollars)	Merchandise Balance (In billions of dollars) [a]	Import Export Ratio	Merchandise Balance (In billions of dollars) [b]	Current Account Balance (In billions of dollars) [c]	GNP (In billions of U.S. dollars)	Current Account as Percent of GNP
Japan	60.4	23.2	37.2	2.60	44.4	35.0	1,232.7	2.8
Taiwan	16.1	4.8	11.3	3.35	N/A	N/A	N/A	N/A
West Germany	17.8	8.8	9.0	2.02	22.2	6.4	621.4	1.0
Hong Kong	8.9	3.1	5.8	2.87	N/A	N/A	N/A	N/A
Brazil	8.3	2.6	5.6	3.14	6.5[d]	-6.8[d]	209.8[e]	-3.2[e]
Italy	8.5	4.3	4.2	1.98	-3.2[d]	0.6[d]	352.1[d]	0.2[d]
South Korea	10.0	5.8	4.2	1.72	-1.8[d]	-1.6[d]	75.3[d]	-2.1[d]
WORLD TOTAL	341.2	217.9	123.3	1.57				

SOURCES: U.S. Department of Commerce and International Monetary Fund.

NOTE: U.S. imports are customs value plus freight, insurance and other changes; U.S. exports are valued free along side.

N/A = Not available.

a. Country's surplus of merchandise exports to United States over imports from United States.
b. Country's surplus of merchandise exports over imports.
c. Country's surplus of merchandise and service exports over imports.
d. Data for 1983.
e. 1983 estimate.

basis. Using the current account as a criterion for bilateral targeting would have produced a very different list of countries than the one presented in Table 1. Its use as a trigger, however, could lead to an overly retaliatory policy in the near future when capital income flows to the United States, which have been in surplus, turn to a deficit, as the United States becomes a net debtor nation.

Similarly, the merchandise trade surpluses of other nations look less imposing when viewed from a current account perspective. Japan's global current account surplus is still relatively high, at $35 billion, but substantially less than its global merchandise trade surplus of $44 billion. Moreover, because of current account deficits other countries that might be targeted on the basis of large bilateral merchandise trade deficits with the United States have much smaller, or negative, current account to GNP ratios. Brazil had a bilateral merchandise trade surplus of $5.6 billion with the United States in 1984, but, as a result of payments on its large foreign debt, had a current account to GNP ratio of negative (-) 3.2 percent in 1983 (the last year for which these data are available). West Germany, which ran a bilateral merchandise trade surplus against the United States in 1984 of 1.5 percent of its GNP, and a bilateral merchandise export/import ratio of 2.0, had an overall 1.0 percent current account to GNP ratio and a global current account export/import ratio of 1.1 in that year. Moreover, singling out the merchandise trade account as a criterion for targeting surcharges, as opposed to the broader current account, makes the implicit judgment that trade in merchandise is more valuable or important than comparable trade in services.

Origin Swapping

Targeted surcharges are prohibitions on nations, not goods. Restrictions on imports from targeted nations could be overcome in the aggregate by shifting the origins of imports. To the extent that these shifts lead newer, higher cost exporters to enter markets, economic efficiency and U.S. real incomes would be reduced. At one extreme, targeted surcharges could lead to a round of counterproductive "origin swapping," in which targeted nations send their exported goods to non-U.S. markets, while the existing exporters to non-U.S. markets divert their merchandise toward the United States. For example, Japanese steel might be diverted from the United States to the European market, while French steel would be substituted for absent Japanese exports in the United States market. To the extent that such origin swapping occurs, losses in efficiency in the United States would be less than if there were not the possibility of shifting suppliers. But even in

the extreme case where existing suppliers were only rearranged, these imports would be redirected to destinations with higher transportation costs and, therefore, global economic efficiency would still be reduced.

In the long run, if foreigners did not expect the surcharge to be removed, new sources of imports could emerge. Table 2 lists the leading suppliers of some major U.S. imports from possible target countries (see Appendix I for a more detailed listing). As the table shows, significant alternative sources already exist for many products. For example, in the short run, a surcharge on steel and semiconductors from Japan could, to some extent, be made up from imports from Canada, South Asia, and elsewhere. If these nations provide alternative exports, the overall U.S. trade position would not change, although higher production and transportation costs from alternative suppliers would be incurred. Moreover, to the extent that imports from targeted nations are not replaced by alternative imports, they would be replaced by domestic substitutes at the cost of the losses in economic efficiency referred to above.

Effects on Targeted Nations

Restrictive trade action can have serious effects on the domestic economies of targeted countries. If the targeted country cannot find alternative markets for its products, its national income will be lowered. This can have two important negative consequences for the United States. First, lower income in the targeted country will translate into fewer purchases of imports from the United States. In the case of some small countries, this may be of negligible importance to the United States. But even Japan, with which the U.S. runs a large trade deficit, consumed U.S. merchandise exports valued at $23.2 billion last year. Lower income in Japan would tend to reduce that figure, and would have a contractionary effect on the U.S. economy. Second, and perhaps more significant, to the extent that the target country is hurt, it will have strong incentive to retaliate by restricting exports from the United States. Retaliation would certainly have a negative effect on the U.S. economy and could lead to further retaliation.

Targeting on the basis of bilateral surpluses can penalize a country whose overall trade is in deficit, but happens to have a trade surplus with the United States. Italy and South Korea, for example, had overall merchandise trade deficits in 1983, while running trade surpluses with the United States. Moreover, some countries need to have trade surpluses, at least temporarily, to compensate for previous large trade deficits and to repay their debt to foreigners. For example, Brazil had large merchandise trade deficits until 1981 (in fact, its current account remains in deficit), and

TABLE 2. LEADING SUPPLIERS OF MAJOR U.S. IMPORTS FROM POTENTIAL TARGET COUNTRIES, 1984 (In millions of dollars)

Product (Standard Industrial Code)	Leading Suppliers	U.S. Imports (In millions of dollars)	Percent of Total U.S. Imports of Product	Percent of Total Imports From Country
Motor Vehicles and Car Bodies (3711)	Japan	15,187	41.07	25.16
	Canada	14,585	39.44	21.80
	West Germany	4,582	12.39	25.73
	Sweden	1,236	3.34	36.08
	United Kingdom	504	1.36	3.35
Total		36,094	97.60	
Steel Products (3312)	Japan	3,100	30.61	5.13
	Canada	1,300	12.84	1.94
	West Germany	997	9.84	5.60
	South Korea	722	7.13	7.20
	France	508	5.02	5.97
Total		6,627	65.44	
Radio and TV (3651)	Japan	5,759	61.51	9.54
	Taiwan	1,001	10.69	6.22
	South Korea	845	9.03	8.43
	Hong Kong	418	4.46	4.70
	Mexico	374	4.45	2.05
Total		8,397	89.69	
Semiconductors (3674)	Japan	1,988	24.38	3.29
	Malaysia	1,454	17.83	51.47
	Philippines	857	10.51	32.68
	South Korea	825	10.12	8.23
	Singapore	673	8.25	16.33
Total		5,797	71.10	
Women's Footwear (3144)	Brazil	728	36.68	8.80
	Italy	526	26.50	6.19
	Spain	247	12.44	9.40
	Taiwan	198	9.97	1.23
	South Korea	104	5.24	1.04
Total		1,803	90.83	

SOURCE: U.S. Department of Commerce.

ports would have to replace the oil sold to Japan with oil purchased from other oil-exporting nations. Although such a pattern would change the bilateral balance between Japan and the United States, Japan and the oil-exporters, and the United States and the oil-exporters, it would leave their total trade balances unchanged. Yet, the economic welfare of each nation would be enhanced because oil exports would be redirected to destinations with lower transportation costs.

RELATIONSHIP TO GATT

The rules of international trade are defined by the General Agreement on Tarifffs and Trade (GATT), which is incorporated in U.S. law through the Trade Act of 1974, as amended. Since its inception, the GATT has facilitated a tremendous expansion of world trade. The volume of global manufacturing trade has risen at an average annual rate of 7.75 from 1963-1983, while world manufacturing production rose by 4.75 percent a year over the same period. But recognizing that increased trade could create domestic problems for countries receiving large and unprecedented quantitites of imports, the GATT provides a number of specific remedies that countries may invoke to overcome these difficulties. Three of these provisions deserve mention:

- Article XII allows restrictions to safeguard the balance of payments;
- Article XIX allows emergency action to protect domestic producers against injury; and,
- Article XXIII provides for dispute settlement where one party perceives that its benefits under GATT have been nullified or impaired by another.

Balance of Payments Safeguards. Under Article XII of the GATT, to safeguard its balance of payments, a country may restrict the quantity or value of merchandise imports, subject to a number of provisions. With the limited exception of conditions agreed to under International Monetary Fund stabilization programs as part of debt restructuring agreements, countries applying Article XII may not discriminate among supplier countries when imposing import restrictions. But Article XII was written under a fixed exchange-rate system and concerned itself with attempts to defend administered exchange-rates that were no longer justified by economic conditions. It may no longer be applicable under a system of floating rates, where exchange

rate values, determined by the market, inevitably will lead foreign transactions to balance.

The "Escape Clause". Article XIX, the so-called escape clause, allows countries to use emergency actions to stem imports when they threaten domestic industry. This provision, however, is product-, not country-specific. Except for retaliatory actions taken in response to another country's escape clause action, Article XIX does not allow for targeted action. The issue of "selectivity" (that is, whether restrictions can be targeted against specific countries) is a current topic of international debate and may be subject to change in a new round of GATT negotiations. A surcharge targeted at individual nations, however, does not appear to be permissable under the GATT escape clause.

Dispute Settlement Procedures. Article XXIII establishes procedures for settling disputes whereby a country may seek retaliation if, in its opinion, the benefits that it expects under GATT have been "nullified or impaired" by the actions of another party, such as the breach of a GATT obligation. Such nullification or impairment is implied by most of the Congressional bills and resolutions now pending that urge the President to retaliate against Japan because of its alleged unfair trade practices. This provision does allow for selectivity in singling out transgressors. It is a cumbersome procedure, however, that involves the approval of other GATT signatories and may nevertheless end in failure. 13/

The Most-Favored-Nation Principle and the Issue of Selectivity

Because the most-favored-nation (MFN) clause is viewed as the cornerstone of the GATT system, targeted actions that discriminate among supplying nations are not legal under GATT. They are simply incompatible with the most-favored-nation commitment embodied in Article I, Section I of the general agreement. The most-favored-nation clause requires each contracting party to the GATT to give equal treatment in applying its tariffs and trade laws to all other GATT nations; that is, a country must extend to all other GATT nations the treatment it provides to its "most favored" trade partner. Nevertheless, the perceived need for direct retaliation against specific countries has led to a number of improptu actions outside of the GATT system, such as orderly marketing agreements and so-

13. The European Community brought a complaint against Japan's industrial practices that failed in part because of the the ambiguous nature of the trade practices Japan was accused of using.

called "voluntary restraint" agreements that are in fact country-specific. Frustration over trade imbalances has led some countries, particularly in the European Community, to urge changes in interpretation of the GATT escape clause (Article XIX) to allow for selective and specific actions aimed at particular suppliers. Until now, the United States has offically taken the position that selectivity would be incompatible with the MFN principle and would lead to the demise of the free international trading sytem.

Would selective discrimination destroy the international trading system, or merely recognize a fact of life? Many observers argue that MFN has been compromised already as a result of the proliferation of sanctioned and unsanctioned exceptions that have been instituted in recent years. These exceptions include allowed exemptions to MFN through preferences to developing nations, customs union and free trade areas, and other extra-legal actions such as bilateral restraint agreements. Little doubt exists, however, that if it is recognized as legitimate, discrimination would tend to raise the overall level of protection and reduce the scope and volume of international trade, thereby reducing global economic efficiency. Some observers maintain that there is no way of sustaining an international system without most-favored-nation treatment. From an economic standpoint, MFN assures that imports will come from the most efficient sources and, at the same time, that all markets will be open to a nations' exports. In other words, it gives full play to comparative advantage.

Even if the MFN principle were to be replaced with selectivity or reciprocity, it could be undesirable to abridge the MFN principle outside of GATT negotiations. Even if successful, it would imply the unilateral abrogation of international trade commitments, thus perhaps seriously damaging the international trading system and casting doubt on the willingness of the United States to maintain its commitments to other negotiated international agreements. Moreover, it could force targeted nations to break their commitments to the MFN principle by either retaliating or offering specific trade concessions to the United States.

Unilateral abrogation of the most-favored nation commitment could have serious repercussions. Most-favored-nation treatment has been a powerful force in opening up the world trading system. Under the MFN principle, an explosion in world trade has provided fuel for the post-war expansions in U.S. and world GNP. Movement away from unconditional MFN will inevitably damage the world trading system and lead to distortions in trading patterns that would reduce the efficiency of the global economy and future world standards of living in the future.

The United States has a key role to play in defining the rules of international trade. The challenge is how to recognize and combat the tensions that arise from unbalanced bilateral trade without undoing the history of post-war progress toward a global free trading system.

APPENDIX

APPENDIX I. LEADING SUPPLIERS OF U.S. IMPORTS FROM POTENTIAL TARGET COUNTRIES, 1984 (In millions of dollars and percents)

Product (Standard Industrial Code)	Leading Suppliers	U.S. Imports (In millions of dollars)	Percent of Total U.S. Imports of Product	Percent of Total Imports From Country
Canned Fruits and Vegetables (2033)	Brazil	774	44.64	9.36
	Spain	159	9.17	6.05
	Taiwan	116	6.69	0.72
	Mexico	97	5.59	0.53
	Philippines	81	4.67	3.09
Total		1,227	70.76	
Wine, Brandy, and Brandy Spirit (2084)	France	576	49.53	6.76
	Italy	330	28.37	3.88
	West Germany	106	9.11	0.60
	Spain	75	6.45	2.85
	Portugal	30	2.58	5.79
Total		1,117	96.04	
Weaving Mills, Manmade Fibers (2221)	Japan	286	31.22	0.47
	Italy	229	25.00	2.69
	South Korea	149	16.27	1.49
	China	31	3.38	0.92
	France	30	3.28	0.35
Total		725	79.15	
Men's Shirts and Nightwear (2321)	South Korea	513	20.80	5.12
	Taiwan	497	20.15	3.09
	Hong Kong	457	18.53	5.14
	China	150	6.08	4.44
	Singapore	135	5.47	3.28
Total		1,752	71.05	
Children's Outerwear NEC (2369)	Hong Kong	1,259	30.18	14.15
	Taiwan	767	18.38	4.77
	South Korea	502	12.03	5.01
	China	258	6.18	7.63
	Italy	213	5.11	2.50
Total		2,999	71.88	

(Continued)

APPENDIX I. Continued

Product (Standard Industrial Code)	Leading Suppliers	U.S. Imports (In millions of dollars)	Percent of Total U.S. Imports of Product	Percent of Total Imports From Country
Leather Apparel	South Korea	253	66.23	2.52
(2599)	Taiwan	26	6.81	0.16
	Italy	16	4.19	0.19
	Argentina	14	3.66	1.34
	Hong Kong	14	3.66	0.16
Total		323	84.55	
Furniture,	Canada	721	28.89	1.08
Fixtures NEC	Taiwan	528	21.15	3.28
(2599)	Italy	178	7.13	2.09
	Denmark	170	6.81	11.20
	Mexico	139	5.57	0.76
Total		1,736	69.55	
Cyclic Crudes	West Germany	343	22.67	1.93
and Intermediates	Japan	296	19.56	0.49
(2865)	United Kingdom	152	10.05	1.01
	Mexico	123	8.13	0.67
	Netherlands	108	7.14	2.49
Total		1,022	67.55	
Industrial Organic	West Germany	338	15.93	1.90
Chemicals NEC	United Kingdom	315	14.84	2.09
(2869)	Canada	233	10.98	0.35
	Brazil	205	9.66	2.48
	Japan	198	9.33	0.33
Total		1,289	60.74	
Miscellaneous	Taiwan	436	21.03	2.71
Plastic Products	Canada	363	17.51	0.54
(3079)	Japan	302	14.57	0.50
	West Germany	183	8.83	1.03
	Hong Kong	142	6.85	1.60
Total		1,426	68.79	

(Continued)

APPENDIX I. Continued

Product (Standard Industrial Code)	Leading Suppliers	U.S. Imports (In millions of dollars)	Percent of Total U.S. Imports of Product	Percent of Total Imports From Country
Men's Footwear	South Korea	227	25.19	2.26
Except Athletic	Taiwan	157	17.43	0.98
(3143)	Italy	145	16.09	1.71
	Brazil	111	12.32	1.34
	Spain	97	10.77	3.69
Total		737	81.80	
Women's Footwear	Brazil	728	36.68	8.80
Except Athletic	Italy	526	26.50	6.19
(3144)	Spain	247	12.44	9.40
	Taiwan	198	9.97	1.23
	South Korea	104	5.24	1.04
Total		1,803	90.83	
Footware,	Taiwan	1,004	56.95	6.24
Except Rubber NEC	South Korea	444	25.18	4.43
(3149)	Italy	104	5.90	1.22
	France	72	4.08	0.85
	Hong Kong	25	1.42	0.28
Total		1,649	93.53	
Blast Furnaces	Japan	3,100	30.61	5.13
and Steel Mills	Canada	1,300	12.84	1.94
(3312)	West Germany	997	9.84	5.60
	South Korea	722	7.13	7.20
	France	508	5.02	5.97
Total		6,627	65.44	
Printing Trades	West Germany	275	41.86	1.54
Machinery	Japan	147	22.37	0.24
(3555)	United Kingdom	83	12.63	0.55
	Switzerland	51	7.76	1.59
	Italy	34	5.18	0.40
Total		590	89.80	

(Continued)

APPENDIX I. Continued

Product (Standard Industrial Code)	Leading Suppliers	U.S. Imports (In millions of dollars)	Percent of Total U.S. Imports of Product	Percent of Total Imports From Country
General Industrial Machinery NEC (3569)	Canada	519	20.57	0.78
	West Germany	483	19.14	2.71
	Japan	415	16.45	0.69
	United Kingdom	252	9.99	1.68
	Italy	186	7.37	2.19
Total		1,855	73.52	
Office Machines and Typewriters (3579)	Japan	4,135	43.74	6.85
	Singapore	1,006	10.64	24.41
	Canada	870	9.20	1.30
	Hong Kong	696	7.36	7.82
	Taiwan	677	7.16	4.21
Total		7,384	78.11	
Radio and TV Receiving Sets (3651)	Japan	5,759	61.51	9.54
	Taiwan	1,001	10.69	6.22
	South Korea	845	9.03	8.43
	Hong Kong	418	4.46	4.70
	Mexico	374	4.45	2.05
Total		8,397	89.69	
Telephone and Telegraph Apparatus (3661)	Japan	959	51.92	1.59
	Canada	290	15.70	0.43
	Taiwan	206	11.15	1.28
	Hong Kong	133	7.20	1.49
	South Korea	63	3.41	0.63
Total		1,651	89.39	
Radio and TV Communication Equipment (3662)	Japan	1,882	43.81	3.12
	Mexico	773	17.99	4.23
	Taiwan	439	10.22	2.73
	Canada	281	6.54	0.42
	Singapore	217	5.05	5.27
Total		3,592	83.61	

(Continued)

APPENDIX I. Continued

Product (Standard Industrial Code)	Leading Suppliers	U.S. Imports (In millions of dollars)	Percent of Total U.S. Imports of Product	Percent of Total Imports From Country
Semiconductors and Related Devices (3674)	Japan	1,988	24.38	3.29
	Malaysia	1,454	17.83	51.47
	Philippines	857	10.51	32.68
	South Korea	825	10.12	8.23
	Singapore	673	8.25	16.33
Total		5,797	71.10	
Electronic Components NEC (3679)	Japan	1,259	50.64	2.09
	Mexico	220	8.85	1.20
	Taiwan	147	5.91	0.91
	Hong Kong	133	5.35	1.49
	West Germany	125	5.03	0.70
Total		1,884	75.78	
Motor Vehicles and Car Bodies (3711)	Japan	15,187	41.07	25.16
	Canada	14,585	39.44	21.80
	West Germany	4,582	12.39	25.73
	Sweden	1,236	3.34	36.08
	United Kingdom	504	1.36	3.35
Total		36,094	97.60	
Motor Vehicles Parts and Accessories (3714)	Canada	6,095	55.41	9.11
	Japan	1,853	16.85	3.07
	Mexico	906	8.24	4.96
	West Germany	600	5.46	3.37
	France	453	4.12	5.32
Total		9,907	90.07	
Photographic Equipment and Supplies (3861)	Japan	2,016	67.76	3.34
	Benelux	160	5.38	4.87
	West Germany	118	3.97	0.66
	France	112	3.76	1.32
	Canada	110	3.70	0.16
Total		2,516	84.57	

(Continued)

APPENDIX I. Continued

Product (Standard Industrial Code)	Leading Suppliers	U.S. Imports (In millions of dollars)	Percent of Total U.S. Imports of Product	Percent of Total Imports From Country
Jewelry and	Italy	646	53.88	7.60
Precious Metal	Hong Kong	127	10.59	1.43
(3911)	Israel	112	9.34	6.19
	Switzerland	72	6.01	2.25
	Peru	34	2.84	2.43
Total		991	82.65	
Sporting and	Taiwan	384	35.13	2.39
Athletic Goods	South Korea	206	18.85	2.05
NEC	Japan	125	11.44	0.21
(3949)	Canada	48	4.39	0.07
	France	40	3.66	0.47
Total		803	73.47	

SOURCE: U.S. Department of Commerce.

NOTE: NEC = Not Elsewhere Classified.